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In the Supreme Court of the United States

OCTOBER TERM, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, PETITIONER

v.

203 NORTH LASALLE STREET PARTNERSHIP

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

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QUESTION PRESENTED

Under Chapter 11 of the Bankruptcy Code of 1978, 11 U.S.C. 1101 *et seq.*, a debtor's plan of reorganization can be imposed over the dissent of some creditors if the plan meets certain criteria. One such requirement is the "absolute priority rule," which provides that, unless and until unsecured creditors are paid in full, "the holder of any claim or interest that is junior to the claims of such class [of unsecured creditors] will not receive or retain under the plan on account of such junior claim or interest any property." 11 U.S.C. 1129(b)(2)(B)(ii). The question presented in this case is:

Whether a plan of reorganization that grants the debtor's equity owners an exclusive opportunity to retain or purchase an ownership interest in the reorganized debtor, without first paying a senior, objecting class of unsecured creditors in full, violates the absolute priority rule.

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INTEREST OF THE UNITED STATES

The United States appears as a creditor in approximately 12,000 to 15,000 bankruptcy reorganization proceedings a year. A number of federal agencies—including the Department of Housing and Urban Development, the Rural Utility Service, the Maritime Administration, and the Commerce Department's Economic Development Administration—frequently appear as the major creditor in single-asset bankruptcy reorganizations analogous to the case at hand. The Internal Revenue Service appears in approximately 10,000 Chapter 11 cases annually, enforcing governmental claims averaging $1.75 billion in aggregated value. Other federal agencies, such as the Small Business Administration, the Department of Agriculture's Farm Service Agency and Rural Housing Service, and the Federal Deposit Insurance Corporation, also often participate as creditors in bankruptcy proceedings.

This case presents the question whether a Chapter 11 reorganization plan can grant the debtor's equity owners an exclusive opportunity to acquire or retain property in the reorganized debtor before senior, unsecured creditors are paid in full. Such plans of reorganization, by allowing equity holders to acquire or retain property interests while the claims of the United States go unpaid, would impose an unwarranted burden on the public fisc and could adversely affect the operation of important governmental programs, such as the provision of low-income housing. In addition, the perpetuation or extension of loan relationships that such plans frequently entail would require taxpayers, in effect, to subsidize reorganization plans that the federal government has concluded are not in the public interest. Accordingly, the United States has an important stake in the resolution of this case.[1]

STATEMENT

1. The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, comprehensively revised bankruptcy law. See *United States* v. *Ron Pair Enterprises, Inc.*, 489 U.S. 235, 238 (1989). As part of this effort, Congress enacted Chapter 11 "with the intention that business reorganizations should be quicker and more efficient and provide greater protection to the debtor, creditors, and the public interest." *NLRB* v. *Bildisco & Bildisco*, 465 U.S. 513, 517 n.1 (1984). The objective of a Chapter 11 proceeding is judicial confirmation of a plan of reorganization that restructures and reschedules the debtor's obligations so that the once-insolvent debtor may emerge as an ongoing concern. See *id.* at 528.[2]

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[1] We also participated in the two cases that previously presented this issue to the Court. U.S. Amic. Br., *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197 (1988) (No. 86-958), and *U.S. Bancorp Mortgage Co.* v. *Bonner Mall Partnership*, 513 U.S. 18 (1994) (No. 93-714).

[2] Individuals, as well as businesses, can pursue reorganization under Chapter 11. *Toibb* v. *Radloff*, 501 U.S. 157, 160-166 (1991). Individual Chapter 11 petitions are uncommon, however. Individuals generally prefer Chapter 13's simplified proceedings for rescheduling consumer debt. 11 U.S.C. 1301 *et seq.*

During the first 120 days after a Chapter 11 petition is filed, only the debtor may file a plan. 11 U.S.C. 1121(b). This period of exclusivity may be extended "for cause." 11 U.S.C. 1121(d). The debtor's plan will generally group creditors into classes based on the substantial similarity of their claims. 11 U.S.C. 1122(a). A single creditor may have more than one claim, thus placing it in more than one class. For example, under 11 U.S.C. 506(a), a federal agency that has a loan secured by property may have its claim bifurcated into a secured claim for the appraised value of the property and an unsecured, deficiency claim for the difference remaining between the appraised value and the balance of the loan.

Section 1129 of Chapter 11 sets forth two alternative paths for judicial confirmation of a reorganization plan.[3] First, Section 1129(a) details thirteen requirements for confirmation of a plan based on the consent of the creditor classes. A class of creditors is deemed to have accepted a plan if their claims are unimpaired—that is, they retain all of their pre-petition legal, equitable, and contractual rights against the debtor. See 11 U.S.C. 1124, 1129(a)(8). Alternatively, a class of creditors accepts a plan if a majority of the creditors and two-thirds of the total dollar amount of the claims within that class vote to approve the plan. 11 U.S.C. 1126(c), 1129(a)(8). Such consent plans must be approved by at least one class whose claims are impaired. 11 U.S.C. 1129(a)(10). In addition, each individual creditor who opposes the plan must receive compensation in an amount that is at least equivalent to what would be received in a Chapter 7 liquidation. 11 U.S.C. 1129(a)(7)(A).

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[3] The text of 11 U.S.C. 1129 is reproduced as an appendix to this brief.

The second route to confirmation is commonly known as a "cramdown," because it imposes the plan over the dissent of an impaired creditor class. See *Kham & Nate's Shoes No. 2, Inc.* v. *First Bank*, 908 F.2d 1351, 1359 (7th Cir. 1990). As long as all of the requirements of Section 1129(a) — except, of course, Section 1129(a)(8)'s consent criterion — are satisfied, the objection of an impaired creditor class can be overridden if "the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. 1129(b)(1).

Paragraph (2) of Section 1129(b) sets forth the minimum requirements for a proposed plan of reorganization to be deemed "fair and equitable." Subparagraph (B) provides that, with respect to unsecured claims, a plan is "fair and equitable" only if the allowed value of the claim is paid in full, 11 U.S.C. 1129(b)(2)(B)(i), or if

> the holder of any claim or interest that is junior to the claims of such [impaired, unsecured] class will not receive or retain under the plan on account of such junior claim or interest any property.

11 U.S.C. 1129(b)(2)(B)(ii). The latter requirement is known as the "absolute priority rule." See, *e.g.*, *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 202 (1988).[4]

2. Respondent is an Illinois limited partnership that owns 15 floors of office space in a building in Chicago's central business district. Pet. App. 2a. Petitioner holds a non-recourse mortgage on the office property as security for a $93 million loan. *Ibid.* Respondent defaulted in January 1995. Shortly thereafter, petitioner's predecessor began foreclosure proceedings in state court. *Ibid.* Respondent promptly filed a voluntary petition for reorganization under Chapter 11, which automatically stayed the foreclosure proceeding. *Ibid.*; 11 U.S.C. 362.

[4] Even if a plan satisfies all of paragraph 2's minimum requirements, the court still must independently determine that the plan is "fair and equitable." 11 U.S.C. 1129(b)(1) and (2).

Petitioner is the major creditor in the bankruptcy proceeding. The only other outside creditors were a state claim for real estate taxes and $90,000 in trade debt. Pet. App. 3a, 103a. Respondent's available assets were the property and a cash account of approximately $3 million. *Id.* at 103a. The bankruptcy court valued the office space at $54.5 million. The court thus allowed petitioner a secured claim in the amount of $54.5 million and an unsecured claim of $38.5 million, which reflected the deficiency between the actual property value and the remaining debt owed by respondent. See 11 U.S.C. 506(a), 1111(b).

It is undisputed that respondent's primary motivation for seeking reorganization was to retain ownership of the property so that its partners could avoid approximately $20 million in personal tax liabilities that would come due upon a sale of the real estate. Pet. App. 3a, 59a. Accordingly, respondent proposed a plan under which its partners would contribute $6.125 million over the course of five years and, in exchange, would retain an ownership interest in the reorganized debtor. The trade creditors and state tax claim would be paid in full. Petitioner's secured claim would be paid, but under new terms: prompt cash payment of $1,149,500 plus a secured, 7-year note (extendable to 10 years at the debtor's option). In addition, petitioner would receive a "commitment fee"[5] and a 50% "participation interest" in the value of the property at the end of the note period. *Id.* at 4a-5a, 57a-59a.[6]

[5] The plan proposed a fee between $266,975 and $545,000; the court set the fee at $266,975. Pet. App. 127a n.4.

[6] From the remaining value of the property at the time of sale or refinance, payments would occur in the following order: "(a) on petitioner's unsecured deficiency claim, payment in full, without interest; (b) for the new capital contributions, payment in full, with interest at varying rates; (c) on the second mortgage held by the general partner,

Petitioner opposed the plan, but the class of trade creditors voted to accept it.[7] The bankruptcy court approved the plan over petitioner's objection that it violated the absolute priority rule. Pet. App. 135a-140a. The district court affirmed. *Id.* at 79a-82a.

3. A divided panel of the Seventh Circuit affirmed. Pet. App. 1a-47a. The majority ruled that this Court's decision in *Case* v. *Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939), established a new value exception to the absolute priority rule. Pet. App. 14a. The majority acknowledged that, "[a]s a matter of abstract logic, and certainly of semantics," respondent's partners were "receiving or retaining" property under the plan "on account of" their "old equity interest" in the debtor, within the meaning of the absolute priority rule. *Id.* at 17a. The court determined, however, that Congress "might well have intended" to require "a more direct causation." *Ibid.* Under this reading, the partners were "allowed to participate in the reorganized entity 'on account of' a new, substantial, necessary and fair infusion of capital," rather than on account of their interest in the debtor. *Ibid.*

Judge Kanne dissented. Pet. App. 32a-46a. He concluded that the new value exception crafted by the majority "belittles the straightforward language of § 1129(b)(2)(B)(ii)" and overlooks that the debtor's partners were permitted to infuse new value into the debtor solely "'on account of'

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full payment with 10% simple interest; and (d) to the debtor's partners in proportion to their contribution of new capital." Pet. App. 58a.

[7] Because the plan classed petitioner's unsecured claim separately from the trade creditors' unsecured claims, petitioner's opposition did not suffice to halt the plan. See 11 U.S.C. 1126(c), 1129(a)(10). The bankruptcy court rejected petitioner's contention that the classifications were gerrymandered to obtain the requisite approval by a single class. Pet. App. 147a-152a. Petitioner did not seek this Court's review of that issue. Petitioner raised a number of other objections to the plan (*id.* at 114a-135a, 141a-154a), but it did not seek this Court's review of those questions either.

their unique status as prior equity holders." *Id.* at 34a. Judge Kanne further noted that, in the immediately preceding subsection of Section 1129, the phrase "'on account of such claim' takes a simple, ordinary 'but for' or 'because of' meaning," and urged that the identical words in the two subsections should be given the identical meaning. *Id.* at 37a. In addition, the dissent challenged the majority's assumption that Congress implicitly incorporated the new value exception into the 1978 Bankruptcy Code. *Id.* at 41a-42a. Finally, the dissent pointed out that the new value exception "creates an anachronism by cutting and pasting pre-Code practice into a fundamentally different bankruptcy context." *Id.* at 46a.

SUMMARY OF ARGUMENT

As evidenced by the plain language, structure, and legislative history of the Bankruptcy Code, Congress intended the absolute priority rule to be absolute. Respondent's attempt to engraft a new value exception onto Section 1129(b) rests upon an unnatural and artificial construction of the statutory text and relies upon 40-year-old dicta and policy arguments that have little modern currency due to Congress's fundamental restructuring of bankruptcy law in 1978. If Congress had wanted to craft an exception for new value or to permit debtors to retain property interests in advance of creditors, it would have said so explicitly, as it has in other chapters of the Bankruptcy Code.

1. The absolute priority rule prohibits confirmation of any plan under which the owners of a failed business retain or receive property "on account of" their interest in the debtor while objecting senior creditors go unpaid. As it does throughout Chapter 11, "on account of" means "for" or "because of." The phrase thus refers to the basis on which the holder of a claim or interest has some entitlement to the debtor's property.

The office space retained by and the equity interests acquired by the debtor's owners in this case were "on

account of" their prior equity claims. The owners' claim or interest in the debtor was the defining criterion for acquiring property under the plan. Money alone was insufficient. The court of appeals, in effect, read the absolute priority rule to prohibit junior interests from acquiring property ahead of senior unpaid claimants only when that property is obtained "*entirely* on account of" or "*solely* on account of" a prior, junior interest, and not where new money is also contributed. Such words of limitation, however, make no appearance in the statutory text, and judicial imposition of such a construction would be inconsistent with the phrase's meaning elsewhere in Chapter 11.

2. Resort to legislative history is unnecessary because the statutory text forecloses the new value exception. In any event, the history of the Bankruptcy Reform Act of 1978 confirms the inappropriateness of reading such an exception into the absolute priority rule. The exception makes no appearance in the House or Senate Report, and the categorical terms in which the House Report speaks counsel against such a substantial deviation from the statute's text. Congress, moreover, considered and rejected proposed bills that explicitly contained a new value exception. Congress chose, instead, to allow voting by classes of claimants and the economic interests of creditors to determine whether a debtor's plan to infuse capital is workable and in the creditors' best interests. Allowing the debtor and the bankruptcy court to impose a new value plan over the objection of a major creditor, as occurred here, would frustrate Congress's carefully calibrated scheme and fundamentally skew the balance between debtors and creditors struck by Chapter 11.

3. Modification of the statutory text cannot be justified on the ground that Congress implicitly incorporated the new value exception into the Bankruptcy Code. At the time the Code was enacted, the new value exception lived only in infrequent dicta. Neither this Court nor any other

decisions of which we are aware had upheld imposition of a new value plan over the objection of a dissenting creditor. A rule of statutory construction that places on Congress the burden of expressly disavowing every bankruptcy option mentioned in dicta would be both inappropriate and unworkable.

The bankruptcy world in which the new value dicta were uttered, moreover, bears little resemblance to that governed by the 1978 Bankruptcy Code. Under prior law, a single, minority creditor could derail a reorganization plan over the consent of all creditor classes. The provision for class-based consent to plans in the 1978 Bankruptcy Code eliminates that problem. Thus, new value plans under the modern Bankruptcy Code would serve, not to circumvent the gadfly creditor, but to impose a plan over the objection of the debtor's largest creditor. There is no adequate basis to believe that Congress's plainly worded absolute priority rule was intended to permit—as occurred here—schemes that leave property in the hands of the very owners who presided over the business's insolvency solely to perpetuate their tax shelter, while the property's major creditor goes unpaid.

ARGUMENT

SECTION 1129(b) OF THE BANKRUPTCY CODE BARS CONFIRMATION OF A REORGANIZATION PLAN THAT PERMITS THE DEBTOR'S EQUITY OWNERS TO RETAIN OR ACQUIRE PROPERTY OVER THE OBJECTION OF A SENIOR, UNPAID CREDITOR CLASS

The "absolute priority rule" provides that the "holder of any claim or interest that is junior to the claims of" an unsecured and unpaid creditor class "will not receive or retain under the plan on account of such junior claim or interest any property." 11 U.S.C. 1129(b)(2)(B)(ii). Here, the equity interests of respondent's owners are unquestionably junior to petitioner's unsecured deficiency claim.

Nor is there any doubt that the plan permitted the junior equity interests both to retain and receive "property." The owners retained possession of the office space and received the exclusive option to purchase ownership interests in the reorganized debtor.[8] The only question is whether that property was received and retained "on account of" the owners' equity interest in the debtor. The language, structure, and legislative history of Chapter 11 leave no doubt that it was.[9]

A. The Plain Language Of The Absolute Priority Rule Admits Of No New Value Exception

1. The task of determining whether an unwritten new value exception exists "begins where all such inquiries must begin: with the language of the statute itself." *United States* v. *Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241 (1989). Nothing in the text of Chapter 11 recognizes or supports the existence of a new value exception. To the contrary, the absolute priority rule is (true to its name)

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[8] See *Norwest Bank Worthington* v. *Ahlers*, 485 U.S. 197, 207-208 (1988); see also *Phillips* v. *Washington Legal Found.*, No. 96-1578 (June 15, 1998), slip op. 12; *In re Coltex Loop Central Three Partners*, 138 F.3d 39, 43 (2d Cir. 1998); *In re Bryson Properties, XVIII*, 961 F.2d 496, 504 (4th Cir.), cert. denied, 506 U.S. 866 (1992); *Kham & Nate's Shoes No. 2, Inc.* v. *First Bank*, 908 F.2d 1351, 1360 (7th Cir. 1990); D. Baird, *The Elements of Bankruptcy* 261 (1993) ("The right to get an equity interest for its fair market value is 'property' as the word is ordinarily used. Options to acquire an interest in a firm, even at its market value, trade for a positive price. They are bought and sold every day.").

[9] The courts of appeals have split on this question. Compare *Coltex*, 138 F.3d at 42-45 (no new value exception); *In re Greystone III Joint Venture*, 995 F.2d 1274, 1282-1284 (same), vacated in part, 995 F.2d 1284 (5th Cir. 1991), cert. denied, 506 U.S. 821 (1992), with Pet. App. 1a-31a (new value exception exists); *In re Bonner Mall Partnership*, 2 F.3d 899, 906-917 (9th Cir. 1993) (same), cert. dismissed, 513 U.S. 18 (1994); see also *Bryson*, 961 F.2d at 503-505 (new value exception is questionable) (dicta); *In re U.S. Truck Co.*, 800 F.2d 581, 588 (6th Cir. 1986) (assuming that new value exception exists).

absolute in its terms. The new value exception relied upon by the court of appeals thus "has no statutory reference point." *Shannon* v. *United States*, 512 U.S. 573, 583 (1994).

By contrast, when Congress wishes to carve out exceptions to its general rules based on the payment of "new value," it does so explicitly. See 11 U.S.C. 547(a)(2) and (c) (exception to power of trustee to avoid certain pre-petition transfers). Similarly, where Congress intends to permit debtors to retain some property before creditors are paid in full — as in Chapters 12 and 13 of the Bankruptcy Code — it omits the absolute priority rule from the criteria for confirmation of a plan. 11 U.S.C. 1225, 1325; see also *In re A.V.B.I., Inc.*, 143 B.R. 738, 747 (Bankr. C.D. Cal. 1992). "[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act," courts must "presume[] that Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Gozlon-Peretz* v. *United States*, 498 U.S. 395, 404 (1991).

2. The statutory language, moreover, is unambiguous in prohibiting new value plans. According to the absolute priority rule, until senior creditors are paid in full, junior claimants may not obtain any property "on account of" their junior interest in the debtor. The common understanding of the phrase "on account of," both now and at the time the Bankruptcy Code was enacted, is "for," "because of," and "by reason of."[10] Throughout Chapter 11, and Section 1129 in particular, the phrase "on account of" appears in a context that confirms that ordinary meaning because it describes the basis on which a claimant may receive

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[10] See, *e.g.*, *The Random House Dict. of the English Language* 13 (2d ed. 1987); *Webster's Third New Int'l Dictionary* 13 (1976); *The American Heritage Dictionary* 9 (1980); cf. *Cohen* v. *De La Cruz*, 118 S. Ct. 1212, 1217 (1998) (under Bankruptcy Code, debt "for" means debt "on account of").

property of the debtor.[11] In other words, in bankruptcy proceedings, creditors receive property distributions "for," "because of," and "on account of" their respective claims and interests in the debtor.[12]

Even outside the bankruptcy context, "on account of" is generally accorded a similar connotation. See, *e.g.*, *Turner Broadcasting System, Inc.* v. *FCC*, 512 U.S. 622, 641 (1994) (discussing government action "that stifles speech on account of its message"); *Spallone* v. *United States*, 493 U.S. 265, 268 (1990) (discussing housing discrimination "on account of race or national origin").

The plan explicitly provided for the debtor's owners to retain and receive property "because of" and "by reason of" their equity interests in the debtor. The plan gave the partners the exclusive right to contribute new capital and receive, in exchange, ownership shares in the reorganized debtor. J.A. 37-39. No other creditor, participant in the bankruptcy proceeding, or outsider was eligible to receive that property. The owners' "junior claim or interest" in the debtor, 11 U.S.C. 1129(b)(2)(B)(ii), thus defined their eligibility both to retain possession of the office space and to obtain shares in the reorganized debtor. It would therefore blink reality to say that the owners did not obtain property "because of" or "on account of" their equity holdings in the debtor.[13]

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[11] See, *e.g.*, 11 U.S.C. 1111(b)(1)(A); 11 U.S.C. 1129(a)(7)(A)(ii) and (B), (a)(9)(A) and (C); 11 U.S.C. 1129(b)(2)(A)(i)(II), (2)(B)(i), (2)(C)(i) and (ii).

[12] Other provisions of the Bankruptcy Code employ the phrase in a similar manner. See, *e.g.*, 11 U.S.C. 547(b)(2), 547(c)(4)(B). *Webster's* also adds "for the sake of" to its definition of "on account of." *Webster's Third*, *supra*, at 13. That definition is unhelpful to respondent and is an unnatural connotation for the phrase as it appears in other sections of the Code.

[13] It is sometimes suggested that such exclusivity simply reflects the fact that no one other than the debtor's owners would want to acquire interests in an insolvent business. *E.g.*, *Bonner Mall*, 2 F.3d at 911. Even if accurate, that observation would not change the plain language of the statute or its signification. Furthermore, major creditors may well be interested in acquiring shares in the reorganized debtor so that they can obtain a controlling interest in the business and thus dictate its future operation or dissolution. See *Greystone*, 995 F.2d at 1283.

3. While both courts of appeals that have recognized a new value exception invoked the alleged ambiguity of Congress's language to justify resort to non-textual interpretation, neither court, in fact, had difficulty understanding the absolute priority rule's ordinary meaning. The Seventh Circuit candidly acknowledged that "[a]s a matter of abstract logic, and certainly of semantics," the owners' acquisition and retention of property was "on account of" their equity interests in the debtor. Pet. App. 17a. Likewise, the Ninth Circuit in *In re Bonner Mall Partnership*, 2 F.3d 899 (1993), cert. dismissed, 513 U.S. 18 (1994), "recognize[d] that in some larger sense the reason that former owners receive new equity interests in reorganized ventures is that they are former owners." *Id.* at 909. Both courts nevertheless concluded that Congress intended a "more direct causation," and thus ruled that the property interests were obtained "on account of" the infusion of new capital. Pet. App. 17a; see also *Bonner Mall*, 2 F.3d at 909. There are three flaws in that reasoning.

First, that construction rests on an artificial singleness of causality. The court of appeals effectively inserted "solely" or "entirely" in front of the phrase "on account of," insisting that the junior claim or interest be the exclusive cause for the property acquisition. "Had Congress intended the narrow construction" that the court of appeals adopted, "it could have so indicated. It did not, and [this Court should] decline to introduce that additional requirement on [its] own." *Smith* v. *United States*, 508 U.S. 223, 229 (1993); see also *Kawaauhau* v. *Geiger*, 118 S. Ct. 974, 977 (1998) (declining to adopt interpretation of

Bankruptcy Code where, if Congress so intended, "Congress might have selected an additional word or words").

Such a straitened reading, moreover, does not comport with ordinary usage. Indeed, under most plans, a claimant is not paid solely or entirely because of its claim, but also because the debtor believes that the manner in which payment is allotted will increase the prospects for business revitalization or for plan confirmation. That the phrase "on account of" is sufficiently capacious to embrace more than one causative factor at a time does not justify altering or limiting its core meaning.[14]

In addition, "on account of" does not appear in contradistinction to any words or phrases that warrant according it such a narrow reading. See *Smith*, 508 U.S. at 229; *Smiley* v. *Citibank (South Dakota), N.A.*, 517 U.S. 735, 746-747 (1996). Nor, given the proliferation of the phrase "on account of" throughout Section 1129, would there have been any reason for Congress to impose such a cramped construction in those other contexts. See *Cohen*, 118 S. Ct. at 1217 ("equivalent words have equivalent meaning when repeated in the same statute").

Second, the court of appeals' reasoning overlooks that the plan afforded the equity holders an option to purchase shares before they contributed any capital at all. The acquisition of that property interest — the option to purchase new shares — was entirely and exclusively attributable to the partner's junior equity interest in the debtor. The plan did not offer any creditor, or anyone else for that matter, an equivalent opportunity to purchase interests in the reorganized debtor.

Third, the court of appeals' ruling fails its own direct causation test. The contribution of new money alone could

[14] Cf. *Smith*, 508 U.S. at 228-237 ("use" of a firearm includes both use as a firearm and for barter); *Phillips* v. *Martin Marietta Corp.*, 400 U.S. 542, 544 (1971) (employment discrimination against women with pre-school-age children constitutes discrimination on account of sex) (per curiam).

not entitle a person to equity interests under the plan. Otherwise, petitioner or another creditor could have purchased a controlling interest in respondent. While the willingness to pay money was a necessary condition of the purchase, it was not sufficient. Status as the holder of an existing equity interest was the indispensable prerequisite to participation in the sale.[15]

4. Holding that the owners acquired property "on account of" or because of their equity interests would not, as some have suggested, render the phrase surplusage. See *Bonner Mall*, 2 F.3d at 909. The "on account of" language identifies for which claim persons are receiving property under a plan. The phrase, in other words, makes clear that the absolute priority rule is claim specific, rather than creditor specific. Bankruptcy creditors can, and often do, have more than one type of claim. "On account of" ensures that, while those creditors cannot receive property because of their equity interests ahead of an unsecured creditor, payments on account of their separate secured and non-junior unsecured claims will not run afoul of the absolute priority rule.

5. Just as the task of construing Section 1129 begins with its plain text, "[i]n this case it is also where the inquiry should end, for where, as here, the statute's language is plain, the sole function of the courts is to enforce it according to its terms." *Ron Pair*, 489 U.S. at 241 (internal quotation marks omitted). Given the precision with which Congress has spoken, "reference to legislative history and to pre-Code practice is hardly necessary." *Ibid.* Policy arguments and (alleged) historical practice alone cannot justify the creation of "an extra-statutory doctrine," *Bonner Mall*, 2 F.3d at 910 n.25. In any event,

[15] The court of appeals erred in finding the statutory text ambiguous merely because some courts and law professors disagree about its construction. See, *e.g.*, *Smith*, 508 U.S. at 227-237 (ordinary meaning of "use" discerned entirely from statutory text, despite inter-circuit conflict and dissent of three Justices).

neither the legislative history nor pre-Code practice supports the court of appeals' decision.

B. The Legislative History Recognizes No New Value Exception To The Absolute Priority Rule

"Given the clarity of the statutory text, respondent's burden of persuading [the Court] that Congress intended to create or to preserve a special rule" for new value plans "is exceptionally heavy." *Union Bank* v. *Wolas*, 502 U.S. 151, 155-156 (1991). The legislative history of the Bankruptcy Reform Act provides respondent no assistance in that task.

1. The predecessor to the 1978 Bankruptcy Code contained four separate reorganization chapters: Chapter VIII, 11 U.S.C. 205 (1970), governed railroad reorganizations; Chapter X, 11 U.S.C. 501-676 (1970), covered corporate reorganizations; Chapter XI, 11 U.S.C. 701-799 (1970), regulated arrangements and compositions for corporations, partnerships, and individuals; and Chapter XII, 11 U.S.C. 801-926 (1970), established reorganization procedures for non-corporate entities engaged in real estate. H.R. Rep. No. 595, 95th Cong., 1st Sess. 221 (1977). Of the four, only Chapters VIII and X predicated confirmation of a reorganization plan on a finding by the court that the plan was "fair and equitable." See 11 U.S.C. 205(e), 621 (1970). Those sections, however, offered no definition of "fair and equitable." It was in the course of defining the "fair and equitable" standard that courts adopted the absolute priority rule to limit insider collusion. *Ahlers*, 485 U.S. at 202.[16]

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[16] See also *Northern Pacific Ry.* v. *Boyd*, 228 U.S. 482, 504-508 (1913) (absolute priority rule prevents senior creditors and stockholders from colluding to impair the interests of intermediate creditors); *Louisville Trust Co.* v. *Louisville N.A. & C. Ry.*, 174 U.S. 674, 684 (1899); *Railroad Co.* v. *Howard*, 74 U.S. (7 Wall.) 392, 409-411 (1869); J. Ayer, *Rethinking Absolute Priority after Ahlers*, 87 Mich. L. Rev. 963, 1022 (1989).

By the time of *Case* v. *Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939), the absolute priority rule had become a "fixed principle" for the determination of whether reorganization plans satisfied the "fair and equitable" standard. *Id.* at 116. In *Los Angeles Lumber*, this Court refused to confirm a reorganization plan under Section 77(b) of the Bankruptcy Act of 1898, ch. 204, 47 Stat. 1475, 11 U.S.C. 205(e) (1934) (Chapter X's predecessor), because it violated the absolute priority rule. 308 U.S. at 122-132. The Court ruled that the stockholders' pledge of their "financial standing and influence in the community" and the "continuity of management" constituted too "ephemeral" a contribution to justify retention of ownership interests in the reorganized enterprise at the expense of unpaid senior creditors. *Id.* at 122-125. The Court stated in dicta, however, that "there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor." *Id.* at 121. Where the old stockholders' participation is a "necessity" and they "make a fresh contribution and receive in return a participation reasonably equivalent to their contribution," the Court explained, "the creditor cannot complain that he is not accorded his full right of priority against the corporate assets." *Id.* at 121-122 (internal quotation marks omitted). Nothing in the legislative history suggests that Congress intended to incorporate those new value dicta into the absolute priority rule it codified in Section 1129.

2. Neither the House nor the Senate Report mentions, let alone supports, the existence of the new value exception discussed in *Los Angeles Lumber*. See H.R. Rep. No. 595, *supra*; S. Rep. No. 989, 95th Cong., 2d Sess. (1978). The House Report does note the *Los Angeles Lumber* decision. H.R. Rep. No. 595, *supra*, at 222 n.8. The citation only indicated, however, that the absolute priority rule applied to Chapter X reorganizations. That statement could hardly be characterized as an endorsement of the new value dicta.

Indeed, the House Report's discussion of the absolute priority rule is emphatic and unconditional in its breadth. "Simply put, the bill requires that the plan pay any dissenting class in full before any class junior to the dissenter may be paid *at all*." H.R. Rep. No. 595, *supra*, at 224 (emphasis added). Under the absolute priority rule, the Report reiterated, if an impaired class is paid less than in full, "then *no* class junior [to it] may receive *anything* under the plan." *Id.* at 413 (emphasis added).[17] Furthermore, the House Report acknowledged that its codification of the absolute priority rule did not entail a wholesale importation of the judicially created rule. *Id.* at 224 ("The rule is a partial application of the absolute priority rule now applied under chapter X."); *id.* at 414. Because Congress explicitly modified the scope of the judicial rule it incorporated, this Court should be especially reluctant to superimpose additional judicial glosses on the statutory text.

3. a. The evolution of the bankruptcy reform legislation also evidences Congress's intention not to codify a new value exception to the absolute priority rule. In this regard, "it is crucial here to grasp not only what Congress did, but what it chose not to do." J. Ayer, *Rethinking Absolute Priority after Ahlers*, 87 Mich. L. Rev. 963, 978 (1989).

The revision process began in 1970 with the creation of the Commission on the Bankruptcy Laws of the United

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[17] See also H.R. Rep. No. 595, *supra*, at 416 (cramdown plan can be confirmed if "junior classes *will receive nothing* under the plan") (emphasis added), 417 (the Bill "allows confirmation if junior interests are not compensated"), 225 (discussing absolute priority rule without hinting at new value exception). The Senate Report offered little discussion of the absolute priority rule and contained no mention of the new value exception. S. Rep. No. 989, *supra*, at 126-128. Because the version of Chapter 11 that was ultimately enacted derived predominantly from the House bill, the statements in the House Report are more relevant to the statutory inquiry presented in this case.

States "to study and recommend changes in the bankruptcy laws." H.R. Rep. No. 595, *supra*, at 2 (footnote omitted). The Commission filed a report with Congress in 1973 in which it proposed the explicit adoption of a new value exception. H.R. Doc. No. 137, 93d Cong., 1st Sess. (1973), *reprinted at* Vol. B *Collier on Bankruptcy* App. Pt. 4-518 to 4-519, 4-815 (15th ed. rev. 1998). The Commission also suggested expanding the new value exception to allow non-monetary contributions that are "important to the operation of the reorganized debtor." *Id.* at App. Pt. 4-815.

The recommended new value language was included in four proposed bills submitted to the 93d Congress.[18] While the proposed bills contained provisions requiring as a condition of confirmation that a plan be "fair and equitable," none of the proposed bills contained language explicitly codifying the absolute priority rule. The "fair and equitable" standard, moreover, was expressly limited by the proposed new value provision.[19] No further action was taken on the bills. However, each of those bills, with the new value language and the concomitant limitation on the "fair and equitable" standard retained, was reintroduced in the next session of Congress.[20] Extensive hearings were held, during which critics targeted various facets of the proposed new value rule.[21]

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[18] H.R. 10792, 93d Cong., 1st Sess. § 7-303 (1973); H.R. 16643, 93d Cong., 2d Sess. § 7-301(4) (1974); S. 4046, 93d Cong., 2d Sess. § 7-301(4) (1974); S. 2565, 93d Cong., 1st Sess. § 7-303(4) (1973).

[19] H.R. 10792, *supra*, § 7-310(d)(2)(B); H.R. 16643, *supra*, § 7-308(d)(2)(B); S. 4046, *supra*, § 7-308(d)(2)(B); S. 2565, *supra*, § 7-310(d)(2)(B).

[20] H.R. 31, 94th Cong., 1st Sess. §§ 7-303(4), 7-310(d)(2)(B) (1975); H.R. 32, 94th Cong., 1st Sess. §§ 7-301(4), 7-308(d)(2)(B) (1975); S. 235, 94th Cong., 1st Sess. §§ 7-301(4), 7-308(d)(2)(B) (1975); S. 236, 94th Cong., 1st Sess. §§ 7-303(4), 7-310(d)(2)(B) (1975).

[21] See *H.R. 31 and H.R. 32: Bankruptcy Act Revision: Hearings Before the House Subcomm. cn Civil and Constitutional Rights of the Comm. on the Judiciary*, 94th Cong., 2d Sess. Pt. 4, at 2160, 2180-2182,

b. In light of the hearings, substantially revised bills emerged from both the House and Senate. The House bill eliminated the language authorizing new value plans and reiterated the "fair and equitable" condition for plan confirmation. The bill did not, however, propose to codify the absolute priority rule. See H.R. 6, 95th Cong., 1st Sess. §§ 1123, 1129(b) (1977). After Congress received further comments from judges, practitioners, and academics, a lengthy mark-up session produced H.R. 8200, 95th Cong., 1st Sess. (1977), the bill that would eventually become law. See H.R. Rep. No. 595, *supra*, at 3; see also H.R. 7330, 95th Cong., 1st Sess. (1977). In the Senate, a bill analogous to H.R. 8200, S. 2266, 95th Cong., 1st Sess. (1977), was introduced. See S. Rep. No. 989, *supra*, at 2.

As in H.R. 6, the new value language was absent from both the House and Senate bills. H.R. 8200, *supra*, §§ 1123, 1129; S. 2266, *supra*, §§ 1123, 1130; see also H.R. 7330, *supra*, §§ 1123, 1129. Unlike the predecessor bills, however, the House and Senate bills now also included a strict codification of the absolute priority rule. See H.R. 8200, *supra*, § 1129(b)(2)(B)(iv) ("the holders of claims or interests of any class of claims or interests, as the case may be, that is junior to such class will not receive or retain under the plan on account of such junior claims or interests any property"); S. 2266, *supra*, § 1130(c)(2)(B)(iv) (same); H.R. 7330, *supra*, § 1129(b)(2)(B)(iv). With slight modifications, H.R. 8200's elimination of new value language and explicit codification of the absolute priority rule became law on November 6, 1978.[22]

2470, 2636 (1976); *S. 235 and S. 236: The Bankruptcy Reform Act: Hearings Before the Senate Subcomm. on Improvements in Judicial Machinery of the Comm. on the Judiciary*, 94th Cong., 1st Sess. Pt. 2, at 382, 557, 624, 710, 716-717, 733, 1044 (1975).

[22] Floor statements by the managers of the legislation confirmed the categorical operation of the absolute priority rule. See 124 Cong. Rec. 32,408 (1978) (statement of Rep. Edwards) (cramdown plan can be confirmed "as long as no class junior to the dissenting class receives

c. The foregoing history of the legislation refutes any contention that Congress meant to retain the very new value language it eliminated and meant to weaken the strictly worded absolute priority rule it enacted. "Few principles of statutory construction are more compelling than the proposition that Congress does not intend *sub silentio* to enact statutory language that it has earlier discarded." *INS* v. *Cardoza-Fonseca*, 480 U.S. 421, 442-443 (1987); see also *Gulf Oil Corp.* v. *Copp Paving Co.*, 419 U.S. 186, 200 (1974) (Court will not assume "that Congress intended a result that it expressly declined to enact").

Significantly, earlier drafts containing the new value language also felt it necessary to qualify the "fair and equitable" standard for plan confirmation by making it expressly subject to the proposed new value exception. This suggests an understanding that, unless specifically qualified, ordinary operation of the fair and equitable standard—and its component absolute priority rule—would preclude the confirmation of a new value plan. Thus, the fact that the legislation Congress enacted not only deleted the new value provision, but also restored the fair and equitable standard free of such restrictions *and* separately codified the absolute priority rule in broadly worded terms forecloses any argument that Chapter 11 implicitly carried forward the new value exception.

For similar reasons, the suggestion (*e.g.*, Pet. App. 20a; *Bonner Mall*, 2 F.3d at 913) that Congress's rejection of the new value proposal signified only opposition to the bills' broad definition of value misses the mark. Had Congress desired a narrower version of the new value exception, it presumably would have revised the proposed new value language rather than erased it entirely and codified instead an unconditional absolute priority rule. In construing the Bankruptcy Code, this Court should be

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anything at all"); 124 Cong. Rec. 34,007 (1978) (statement of Sen. DeConcini) (same).

"directed by [the statute's] words, and not by the discarded draft[s]." *John Hancock Mutual Life Ins. Co.* v. *Harris Trust & Sav. Bank*, 510 U.S. 86, 101 (1993).

4. Congress's rejection of analogous "give-up" plans further undercuts any argument that new value plans are permissible. Under a give-up plan, senior claim holders consent to have some of the property that is owed to them allocated instead to junior classes, even though intermediate classes are not paid in full. See, *e.g.*, *Kansas City Terminal Ry.* v. *Central Union Trust Co.*, 271 U.S. 445 (1926) (bondholders' surrender of value in favor of stockholders). As reported out of committee, the Senate bill would have permitted "a senior creditor to adjust his participation for the benefit of stockholders." S. Rep. No. 989, *supra*, at 127. The Report explained that "junior creditors, who have not been satisfied in full, may not object if, absent the 'give-up', they are receiving all that a fair and equitable plan would give them." *Ibid.* The House Report, by contrast, stated that the absolute priority rule contained in H.R. 8200, *supra*, § 1129(b)(2)(B)(iv) would foreclose give-up plans. H.R. Rep. No. 595, *supra*, at 416 (the absolute priority rule "is designed to prevent a senior class from giving up consideration to a junior class unless every intermediate class consents, is paid in full, or is unimpaired"). The House's language choice prevailed, and the floor statements that were made in lieu of a conference report confirm that the absolute priority rule bars give-up plans.[23]

Of course, if "on account of" bore the narrow meaning ascribed by the court of appeals, then give-up plans would

[23] See 124 Cong. Rec. 32,408 (1978) (statement of Rep. Edwards) ("[T]he House report remains an accurate description of confirmation of section 1129(b). Contrary to the example contained in the Senate report, a senior class will not be able to give up value to a junior class over the dissent of an intervening class unless the intervening class receives the full amount, as opposed to value, of its claims or interests.").

be permissible, because the value the junior interests receive would arguably be "on account of" an independent decision of the senior creditors. The "on account of" language, however, should not be construed to admit through the back door schemes circumventing the absolute priority rule—whether new value or give-up plans—that Congress specifically considered and rejected during the legislative process.[24]

C. Rejection Of A New Value Exception Is Consistent With Pre-Code Practice

This Court is "reluctant to accept arguments that would interpret the [Bankruptcy] Code * * * to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Dewsnup* v. *Timm*, 502 U.S. 410, 419 (1992). The court of appeals concluded that the new value exception was "ensconced" in pre-Code bankruptcy practice and thus that Congress "'must have enacted the Code with a full understanding' of the absolute priority rule and its new value corollary." Pet. App. 20a (quoting *Dewsnup*, 502 U.S. at 419). There are several significant flaws in that reasoning.

1. Resort to pre-Code practice is appropriate only when the statutory language is ambiguous. *Ron Pair*, 489 U.S. at 241; cf. *Dewsnup*, 502 U.S. at 417 (noting ambiguity in text at issue), 419-420. Congress spoke with such straightforward language in enacting the absolute priority rule that resort to extra-statutory tools of interpretation is both unnecessary and inappropriate.

[24] *Los Angeles Lumber* relied heavily on *Kansas City Terminal*, *supra*, to undergird its new value dicta. 308 U.S. at 121-122. *Kansas City Terminal*, however, involved a give-up plan, not a new value plan. 271 U.S. at 453-456. The fact that the absolute priority rule prohibits give-up plans further counsels against a construction of the rule that would implicitly authorize new value plans while barring the give-up plans that provided the foundation for the new value dicta.

2. The ability of a court to perceive references to a bankruptcy procedure in a few cases prior to 1978 is an insufficient basis for engrafting an unwritten exception onto the Bankruptcy Code. The pre-Code practice must have been "clearly established." *Dewsnup*, 502 U.S. at 418; see also *Kelly* v. *Robinson*, 479 U.S. 36, 45 n.6, 46 (1986) (rule that criminal restitution obligations are non-dischargeable was "widely accepted" and "established" by 1978; only one court had ruled otherwise). The new value exception was not. To the contrary, it lived only in occasional dicta: this Court has never confirmed a new value plan, and neither (to our knowledge) did any other court before 1978.

a. In *Los Angeles Lumber*, the Court first intimated in dicta that a new value exception might be available. 308 U.S. at 121-122.[25] The *Los Angeles Lumber* dicta appeared again in *Marine Harbor Properties* v. *Manufacturer's Trust Co.*, 317 U.S. 78 (1942), but the issue decided was whether the petition was properly dismissed because it was not filed in good faith. *Id.* at 81. The new value dicta arose only in a hypothetical discussion of potential reorganization options. *Id.* at 85-86; see also *Consolidated Rock Prods. Co.* v. *Du Bois*, 312 U.S. 510, 529 n.27 (1941). The dicta made their final pre-Code appearance in *Mason* v. *Paradise Irrigation Dist.*, 326 U.S. 536, 541-543 (1946),

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[25] A brief filed by the United States as amicus curiae in *Los Angeles Lumber* recognized the potential application of a narrow new value exception to the judicially created absolute priority rule. See U.S. Amic. Br. at 14, 40-42, *Case* v. *Los Angeles Lumber Prods. Co.*, *supra*, (Nos. 23 & 24). Our subsequent research has shown that suggestion not to be a correct reflection of the law at that time. In any event, whatever the state of the law in 1939, we have consistently taken the position in subsequent filings in this Court, as we do here, that no new value exception was clearly established at the time of the Bankruptcy Reform Act of 1978, and that Chapter 11 of the 1978 Code does not contain a new value exception. See U.S. Amic. Br., *Ahlers*, *supra*, and *Bonner Mall Partnership*, *supra*.

more than 30 years before enactment of the Code. That case involved the provision of new value by a creditor (not an equity holder) and concerned only whether the differential treatment of creditors within a class precluded confirmation of the plan. *Id.* at 538-542.

Accordingly, the fact that this Court never has addressed the new value issue except in dicta "or relied upon this limitation * * * counsels against concluding that the limitation was well recognized." *Ron Pair*, 489 U.S. at 247.

b. The new value dicta also had no independent existence in the decisions of lower courts. In fact, we are aware of no reported case under the old Chapter X (or its predecessor Section 77(b)) adopting the new value dicta as the basis for confirmation of a plan in the years before 1978.[26] In any event, even if the lower courts had occasionally relied on this Court's dicta, that would not render the practice "well recognized" for purposes of incorporation into the Code. *Ron Pair*, 489 U.S. at 247; see also *United Savings Ass'n* v. *Timbers of Inwood Forest Assoc.*, 484 U.S. 365, 381 (1988).

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[26] See Pet. App. 42a n.5 ("Under Chapter X, no shareholder ever convinced a court that it contributed sufficient value to retain an interest under the new value concept, and no reported case expressly adopted *Case*'s new value *dicta* as its holding until the Code's enactment in 1978."); *Coltex*, 138 F.3d at 44; *Greystone*, 995 F.2d at 1282 ("There is no *there* there."); 7 *Collier*, *supra*, ¶ 1129.04[4][c], at 1129-106 to 1129-108 & n.164 (15th ed. rev. 1998); B. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 92 (1991); Ayer, *supra*, 87 Mich. L. Rev. at 1016 (new value "is nowhere present as a rule of decision in Chapter X cases. New value under Chapter X, then, is an illusion."). Because Chapter XI, under which most other reorganizations were filed prior to 1978, did not contain the absolute priority rule, no cases under that provision addressed the new value dicta either. *Coltex*, 138 F.3d at 44; 7 *Collier*, *supra*, ¶ 1129.04[4][c], at 1129-106 to 1129-107.

c. In sum, rather than "ensconced in our bankruptcy practice" (Pet. App. 20a), the new value exception was "seemingly moribund" by 1978. 7 *Collier*, *supra*, ¶ 1129.04[4][c], at 1129-108. The new value exception's brief flicker in bankruptcy practice is an insufficient basis for importing it into the Code, especially in the face of Congress's plain language and the adverse legislative history. See *Ron Pair*, 489 U.S. at 246 (practice of denying post-petition interest was "recognized by only a few courts and often dependent on particular circumstances"); see also *Timbers*, 484 U.S. at 381.

3. Creation of a new value exception would be inappropriate, as well, because the confirmation scheme crafted by Congress in Section 1129 already occupies the territory covered by the new value dicta. *Wolas*, 502 U.S. at 159. The comments in *Los Angeles Lumber* addressed a concern under the prior Chapter X that a single, minority creditor could employ the absolute priority rule to block new value plans that promote the economic interests of the vast majority of creditors in a reorganization proceeding. In *Los Angeles Lumber*, for example, although more than ninety percent of the creditors and stockholders had approved the reorganization plan, 308 U.S. at 111-112, the objection of a single bondholder who was owed $18,500 was sufficient to bar the plan. See also *Mason*, 326 U.S. at 545-546 & n.14.

In Chapter 11 of the 1978 Bankruptcy Code, Congress created a scheme of structured creditor democracy. Approval of plans and invocation of the absolute priority rule are left to classes of creditors, who act by class vote. A majority of the creditors and two-thirds of the total dollar amount of the claims within a class are required for assent. 11 U.S.C. 1126(c), 1129(a)(8). Also unlike pre-Code practice, if a plan is adopted by consent under 11 U.S.C. 1129(a), the court cannot independently veto it through application of the fair and equitable standard. Only cramdown plans trigger such judicial superintendence. 11

U.S.C. 1129(b)(1). When considered in conjunction with the absolute priority rule, the class democracy principles embodied in Chapter 11 reflect a deliberate choice by Congress of how best to remedy the gadfly creditor problem. By selecting class-based elections, Congress trusted the creditors—who have firsthand experience with the insolvent enterprise and who can best gauge the local business climate—to act in their own economic self interest. When a plan truly maximizes the prospects of recovery and compensation, the requisite majority of creditors can be expected to approve it.[27] Where creditor consent is not obtained, the absolute priority rule prevents the debtor and courts from second-guessing that business judgment. As this Court noted in *Ahlers*, even if a court believes that unsecured creditors "would be better off if respondents' reorganization plan was confirmed * * * [,] that determination is for the creditors to make in the manner specified by the Code * * * and courts applying the Code must effectuate their decision." 485 U.S. at 207.[28]

The new value exception, by contrast, vests "power in the *judge* to 'sell' stock to the managers even when the creditors believe that this transaction will *not* augment the value of the firm." *Kham & Nate's Shoes*, 908 F.2d at 1360. Because Congress already enacted particular provisions to fix the problem that gave rise to the new value dicta, it would be illogical to assume that Congress intended simultaneously to incorporate such a dramatically

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[27] Studies confirm this. See, *e.g.*, L. LoPucki & W. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. Pa. L. Rev. 125 (1990); J. Franks & W. Torous, *An Empirical Investigation of U.S. Firms in Reorganization*, 44 J. Fin. 747 (1989).

[28] See also H.R. Rep. No. 595, *supra*, at 224 ("The premise of the bill's financial standard for confirmation" is that the parties "should make their own decision on the acceptability of the proposed plan of reorganization"; "The parties are left to their own to negotiate a fair settlement."), 226.

different and unstated solution to the same problem. *Wolas*, 502 U.S. at 158.[29] Rather, "the fact that Congress carefully reexamined and entirely rewrote" the reorganization provision in 1978 "supports the conclusion that the text of [Section 1129] as enacted reflects the deliberate choice of Congress." *Id.* at 160.

This is, moreover, not a case where the legislative history is silent. Cf. *Dewsnup*, 502 U.S. at 419. As noted earlier, Congress considered for a number of years versions of bankruptcy reform legislation that authorized new value plans. But in the final legislation, "Congress moved in the other direction, enacting the [absolute priority] rule in an uncompromising form" and choosing to rely, instead, on class democracy to authorize those new value plans that truly maximize the creditors' and debtors' welfare. *Kham & Nate's Shoes*, 908 F.2d at 1362. The court of appeals' decision "is at war with this legislative history." *Wolas*, 502 U.S. at 160 n.15.

4. Finally, the new value dicta are ill-suited for bankruptcy practice under the modernized 1978 Code. Bankruptcy practice, especially in the reorganization arena, "changed substantially in the * * * 40 years" intervening between *Los Angeles Lumber* and the 1978 Bankruptcy Reform Act. H.R. Rep. No. 595, *supra*, at 233.[30] Because the 1978 Code checked the disproportionate power of minority creditors in other ways, new value plans are now apt to be used by debtors and a single class of minority creditors to frustrate the *majority* creditor and to force it into substantial and ongoing financial relationships with the debtor which it no longer desires.

[29] Even the court of appeals recognized that "[the new value exception's] necessity may not be as great today as it was in an earlier period." Pet. App. 22a.

[30] See also H.R. No. 595, *supra*, at 221 ("In 1938, the business reorganization concept was not nearly as well developed as it is today, and the [old statutory] chapters reflect a certain lack of sophistication in handling the myriad problems of modern corporate finance.").

See J.A. 102 ("[W]e do not want to be in a ten year contractual relationship with the debtor."). The fact that a significant percentage of reorganizations ultimately fail underscores the inequity of adopting a new value exception that forces major creditors to subsidize business operations that, in the creditors' judgment, simply postpone the inevitable.[31]

Furthermore, the prior Chapter X (and its predecessor Section 77(b)), provided for the appointment of trustees to supervise the reorganization process. See *A.V.B.I.*, 143 B.R. at 743. Old owners thus could "buy back into the management of the company" only after a trustee "examined the books and operations and * * * unearthed any dishonesty or mismanagement." *Ibid.* Under Chapter 11's debtor-in-possession provision, however, a new value exception would permit uninterrupted control by the debtor's owners. "Creditors often fear that such cases are run for the private benefit of existing salaried management and the equity holders, with the intent of unfairly squeezing out the creditors." *Ibid.*

Correspondingly, the 1978 Bankruptcy Code sharply limited the power of courts to administer equity in a manner untethered to the statutory language. *Ahlers*, 485 U.S. at 206 ("[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code."). Congress took it upon itself to offer an elaborate definition of "fair and equitable," rather than leave the standard to judicial development. In these circumstances, it is particularly unlikely that Congress intended silently to import a new value exception, with the attendant need for courts to

[31] See *In re Kroh Bros. Development Co.*, 100 B.R. 487, 500 (Bankr. W.D. Mo.) ("The Court notes that many, if not most, reorganizations fail."), appeal denied, 101 B.R. 1000 (W.D. Mo. 1989); B. Basil, *The New Value Exception to Absolute Priority in Bankruptcy*, 101 Com. L. J. 290, 304 & n.90 (1996); S. Jensen-Conklin, *Do Confirmed Chapter 11 Plans Consummate?*, 97 Com. L. J. 297 (1992).

define the exception's unwritten terms, such as "money or money's worth," "necessity," and "reasonable equivalence."

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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APPENDIX

TITLE 11-BANKRUPTCY

§ 1129. Confirmation of plan

(a) The court shall confirm a plan only if all of the following requirements are met:

(1) The plan complies with the applicable provisions of this title.

(2) The proponent of the plan complies with the applicable provisions of this title.

(3) The plan has been proposed in good faith and not by any means forbidden by law.

(4) Any payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable.

(5)(A)(i) The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan; and

(ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy; and

(B) the proponent of the plan has disclosed the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider.

(6) Any governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval.

(7) With respect to each impaired class of claims or interests—

(A) each holder of a claim or interest of such class—

(i) has accepted the plan; or

(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; or

(B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in the property that secures such claims.

(8) With respect to each class of claims or interests—

(A) such class has accepted the plan; or

(B) such class is not impaired under the plan.

(9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that—

(A) with respect to a claim of a kind specified in section 507(a)(1) or 507(a)(2) of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim;

(B) with respect to a class of claims of a kind specified in section 507(a)(3), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7) of this title, each holder of a claim of such class will receive—

(i) if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim; and

(C) with respect to a claim of a kind specified in section 507(a)(8) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim.

(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.

(11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

(12) All fees payable under section 1930 of title 28, as determined by the court at the hearing on confirmation of the plan, have been paid or the plan provides for the payment of all such fees on the effective date of the plan.

(13) The plan provides for the continuation after its effective date of payment of all retiree benefits, as that term is defined in section 1114 of this title, at the level established pursuant to subsection (e)(1)(B) or (g) of section 1114 of this title, at any time prior to confirmation of the plan, for the duration of the period the debtor has obligated itself to provide such benefits.

(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition than a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides—

(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims—

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

(C) With respect to a class of interests—

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

(c) Notwithstanding subsections (a) and (b) of this section and except as provided in section 1127(b) of this title, the court may confirm only one plan, unless the order of confirmation in the case has been revoked under section 1144 of this title. If the requirements of subsections (a) and (b) of this section are met with respect to more than one plan, the court shall consider the preferences of creditors and equity security holders in determining which plan to confirm.

(d) Notwithstanding any other provision of this section, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933. In any hearing under this

subsection, the governmental unit has the burden of proof on the issue of avoidance.